

Newsletter

Economic Reform and
Reconstruction
Bosnia and Herzegovina

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The Happiness of the People Depends on Sound Public Finance

The leading article in this issue, on tax reform, begins with a quote from the French king, Louis XIV – *The happiness of the people depends on sound public finance.*

This may seem like a truism -- but the tone and substance of economic and political debate in Bosnia and Herzegovina suggests that this message has not yet been fully absorbed.

Politicians and governments can make all the promises in the world, but if they fail to put in place a system of sound public finance first, they cannot hope to fulfill those promises. Likewise, the public can make all the demands it would like but if a system of sound public finance has not been set in place, those demands cannot and will not be met.

These are the realities all of us in government have to face up to.

Over the last year significant progress has been made in first recognizing and then addressing the issue of BiH's internal debt. The governments of the State, the two Entities and Brcko have already signed up to an agreement; Brcko and the RSNA have already passed the laws and the State and Federation Parliaments are very close to concluding their part as well. These laws are based on a solution, drafted by the governments with the assistance of the IMF and US Treasury, which treats those most vulnerable in the country as a priority. Will everyone like it? Of course not but it is the most reasonable outcome of the financial chaos that currently exists, a situation where the debts of this country amount to more than 200 percent of GDP. The solution offered by the government ensures that the governments can honour their financial obligations to citizens and at the same time lift a huge burden from the BiH economy, opening the way for investment and job creation.

It is a solution based on establishing and maintaining sound public finance so that the governments can start to pay back what they owe. Without an agreement, none of the creditors – including pensioners and workers -- can be paid, and the new investment and job growth will be slow if not completely stalled.

Now is the time for the Parliamentary Members to undertake their promise to reform and to enhance the situation, not to hide behind short-term popularity and demagoguery.

At the same time the State Parliament will begin to review the law introducing VAT and preparing this country for EU membership. Prime Minister Terzic has insisted that the target date for launching VAT should be mid 2005 rather than the start of 2006, and indeed, on 15 July the Council of Ministers adopted the implementing laws on VAT, which will now be debated in Parliament. If the mid-2005 launch date is to be achieved, rapid steps must be taken to make the ITA fully operational (including the provision of adequate budget financing); the ITA must be provided with a suitable permanent headquarters, and it must be properly staffed.

These are the building blocks of a modern taxation system; they are as essential as they are demanding and they must be set in place -- for the very good reason that *the happiness of the people depends on sound public finance.*

Ambassador Donald S. Hays
Principal Deputy High Representative

MACROECONOMIC REVIEW

*"The happiness of the people depends on sound public finance."
Louis XVI*

When Louis XVI made this remark at the outset of his reign, France was labouring under a centuries old fiscal system that had been patched up frequently but never truly overhauled. As a result, the country experienced frequent fiscal crises due not so much to its inability to raise funds but to the grave inefficiencies of its revenue collecting arrangements. More than two centuries later, the governments of Bosnia and Herzegovina have been facing issues and crises of the sort that might have been familiar to ministers at the Court of Versailles. The issue is simple: taxes have to be legislated and collected in a manner that is administratively efficient and politically acceptable.

In general, a viable tax system is indispensable to the good functioning of public finances and fiscal correction is an indispensable tool for governments seeking macroeconomic stability. Indeed, in the case of Bosnia and Herzegovina, this dimension assumes an even greater magnitude owing to the fact that the country's authorities have no discretionary power over monetary policy by virtue of operating a strict currency board regime. In this case, fiscal measures represent one of the chief means of macroeconomic correction in addition to their revenue raising function.

Raising revenues

One of the conclusions reached by Burgess & Stern in their article entitled Taxation and Development¹ was that developing countries, on average, have a greater dependence on indirect as opposed to direct taxes: two thirds and one third respectively. However, the general trend observed in some developing countries was a move away from trade taxes such as customs levies accompanied by a greater reliance on sales taxes. In this respect, their findings pointed to the advent of value added tax (VAT) that has been hailed as the most revolutionary tax tool of the last half-century. They noted that the introduction of VAT was a success in many countries 'in terms of coverage, revenue and simplicity relative to the existing system'². Moreover, many countries experienced significant increases in their tax receipts. Burgess and Stern note that Indonesia, for example, saw VAT revenues rising from 1 percent to 4 percent of GDP in only five years.

¹ Burgess, R & Stern, N.; 'Taxation and Development', *Journal of Economic Literature*, (June 1993)

² Ibid. p. 812

The Burgess and Stern research also showed that, in many cases, the pre-reform conditions were very similar to those found in this country. The chief examples of those are complications in collecting indirect taxation due to an accumulation of ad hoc measures and a weak tax administration. Besides fiscal problems that often gave impetus to tax reform, a number of developing countries also embraced tax reform as complementary to their trade and industrial policy. In this light, the reductions in tariffs and corporate tax rates meant to encourage trade and inward investment had to be offset by alternative revenue generating measures.

On both counts, Bosnia and Herzegovina has more than enough reasons to pursue tax reform seriously. On the hand, its messy indirect taxation system, which often resulted in double taxation, hindered investment and inland trade while the recent attempts to liberalise BiH's trade regime may have already resulted in lower revenues from customs duties. When the domestic governments' considerable reliance on indirect taxes is also taken into account, then the role of the Indirect Taxation Authority of BiH can be considered as nothing short of pivotal. The fact that Mexico, a large country with decentralised government and tax administration structures, managed to find a profitable and workable solution as a result of its indirect tax reform (which saw the successful introduction of VAT) means that there is a good chance that BiH will stand to profit from its ongoing reform efforts. Indeed, the latest news that BiH's VAT rate will be 17 percent with only a few, EU defined, exemptions and with the threshold base of KM 50,000 emboldens one to conclude that the authorities have finally come to realise that the successful outcome of tax reform depends on its simplicity and well defined bases for assessment.

Fiscal policy as a stabilisation tool

In the context of BiH's macroeconomic policy fiscal policy is the only potent tool left to the governments in view of BiH's strict currency board regime. In fact, according to the textbook interpretation of the Mundell-Fleming model, fiscal policy would appear to be more effective as a stabilising measure under fixed as opposed to flexible exchange rate regimes. Research has also shown that government expenditures in currency board countries show greater elasticity and responsiveness to cyclical conditions. Similarly, the composition of these countries' budgets is more biased towards the type of expenditure and revenue that is better suited to providing insurance against economic fluctuations. Thus, fiscal policy under currency board arrangements has to maintain macroeconomic credibility as well as provide automatic stabilisation.

The survey of different economies that operate currency board regimes has shown that constraining the size of the government and budget deficit while emphasising budgetary components that could act as automatic stabilisers discharges this function.³

In the BiH context this conclusion is only beginning to display its full significance. Thus, for the first time since the war, BiH is looking at the prospect of a balanced budget. Similarly, the recent tax reform initiatives have made the whole country subject to a single fiscal policy (in as much as it relates to the indirect taxes that account for most of the governments' tax revenues) which means that the country will soon be able to operate a macroeconomic policy in the true sense of that expression. It is to be hoped that the authorities will be able to capitalise on these achievements and actually develop a coherent macroeconomic doctrine that considers fiscal policy both as a potential stabilising tool and means of realising government revenue.

Theory and practice in the context of economic transition

The context in which tax and potential benefits reforms will be carried out in BiH needs to be stressed in view of the system that existed before. The former Yugoslav system derived most of its tax revenues from a relatively small number of integrated industrial combines which were responsible for administering both payroll and corporation taxes that were transferred to the state or its agencies (e.g. health and pension funds). In that system, corporate taxes often meant transfer of all corporate earnings (that were not reinvested) to the state. Although taxation as a proportion of GDP was high, administration costs were comparatively low owing to a relatively small number of tax subjects and close monitoring by the state, especially via the former Payment Bureaus, which acted as the fiscal agent of the state. With most of the retail and service industry also in state ownership it was no more difficult to collect and administer the highly differentiated, product specific turnover tax on goods and services. However, the collapse of the socialist system meant that the countries of the former Yugoslavia and other transitional economies had to construct a tax system that gathered revenues from a larger number of private enterprises (in respect to both direct and indirect taxation) and even individuals. In a book he edited⁴, Newbery noted that in the countries of

³ Fatas, A. & Rose, A. 'Do Monetary Handcuffs Restrain Leviathan? Fiscal Policy in Extreme Exchange Rate Regimes' *IMF Staff Papers*, Vol. 47 (2001)

⁴ Newbery, David, M.G.; *Tax and Benefit Reform in Central and Eastern Europe* (London, 1995)

Central and Eastern Europe, paradoxically, the easier part was to effect reform of the taxation system, greater difficulty has been encountered in forging a tax paying culture and extracting payments in view of the concurrent output collapse and low tax capacity. Thus, there is often a considerable difference between the effective and legally defined tax rate/system. Using 15 EU countries as a benchmark and a sample of 25 transitional economies of CEE, Schaffer and Turley of the EBRD sought to find out how generally and with what degree of strictness tax policy is implemented and complied with in the representative sample of the transitional economies⁵.

Their results note that besides the tax capacity of a country, there was also a strong correlation between its progress in transition and its effectiveness in tax collection. At the same time, countries such as Belarus and Ukraine whose economies have barely embarked on the process of economic transition and whose governments are still largely authoritarian also scored well on their ability to collect taxes effectively. On the other hand, countries with a weak and highly decentralised state and those that have suffered internal conflicts had low levels of tax compliance and collection. Partial reformers have also scored badly. The general upshot of studies like this tends to be: countries with tax collection problems need to reduce tax exemptions and implement lower tax rates and simpler, rule based, transparent tax regimes. Moreover, according to the empirical results, it would appear that this measure is not at odds with the distributional objectives of many transitional countries' fiscal policies⁶.

Theory and practice in BiH

Different inquiries into the taxation system of BiH have revealed that the country's taxes largely date back to the former Yugoslav system despite the fact that there has been an economic paradigm shift since that country broke up. Some findings moreover point out that the present system is such that if fully enforced (i.e. if the difference between the statutory and effective tax rates were only a minor one), would essentially serve to eliminate the scope for the development of private sector activity⁷. Thus, payroll and personal income

⁵ Schaffer, Mark. E & Turley, Gerard; *Effective versus statutory taxation: measuring effective tax administration in transition economies*, EBRD Working Paper No. 62 (2001)

⁶ Newbery, David, M.G.; *Tax and Benefit Reform in Central and Eastern Europe* (London, 1995)

⁷ Gallagher, Mark & Bosnic, Pero; *Toward an SME-friendly Revenue System in Bosnia-Herzegovina*,

taxes range between 46 percent and 69 percent of salaries in BiH, which discourages formal employment and encourages under-registration of wages actually paid. At the same time, the tax system heavily discriminates in favour of capital, which is contradictory in view of the goal of increasing employment in a country with an unemployment rate of around 20 percent at minimum. Moreover, the institutional arrangements are such that fees and charges are levied at different levels of government via decrees and delegated legislation – i.e. outside the main tax code. Also, it appears to be hard actually to eradicate certain particularly obnoxious fees and taxes for they often re-appear in another form or by another name at a later date. Besides, until very recently, BiH had in effect three different tax regimes operating alongside each other in the two Entities and Brcko District. This often resulted in double taxation and, sometimes, no taxation at all. In general, it would appear that the tax system is such that it impedes business development regardless of size⁸.

With this in mind it should not come as a surprise that the informal or 'grey economy' in BiH has been estimated as an additional 30 or 40 percent of GDP. This informality takes many shapes and forms, from underreporting employment and wages to avoiding taxes and even failing to register a firm as a legal entity. The World Bank estimates that, in developing countries, in sectors such as retailing and construction informality often amounts to as much as 80 percent of employment. Although the informality is frequently viewed as a social issue and as something that will be curbed or disappear as a result of tax reform and a greater degree of economic development (witness the cases of 'advanced' transitional economies mentioned earlier), studies conducted by McKinsey's research arm (McKinsey Global Institute) points to a more insidious nature of the 'grey' or informal economy⁹.

McKinsey's research shows that informality actually stifles a country's long-term economic growth and productivity. McKinsey's findings hence point to the fact that a large incidence of informality in the economies of Portugal and Turkey accounts for almost one half of those countries' productivity gap with the USA. Thus, the peculiar self-reinforcing dynamics of the grey economy keep the firms that operate 'in the grey' at suboptimal scale, inefficient and unproductive. BiH-related evidence points to the truth of these findings; a small businessman interviewed by USAID confessed

USAID Tax Administration Modernisation Project Report (March 2004)

⁸ Ibid.

⁹ Farrell, Diana; *The Hidden Dangers of the Informal Economy*, The McKinsey Quarterly, No.3 (2004)

that he would not be able to remain in business if he actually paid all his taxes in full. At the same time, he noted that the local tax authorities probably guessed as to the fact that he was underreporting his tax liabilities but were content to let him carry on regardless because he is not a "fat fish" and keeps his head under the parapet by remaining small¹⁰. The social cost of this is not only measured in terms of the ultimate shortfalls in the provision of public services and welfare but also in terms of consumer choice. So, the consumer in BiH is typically faced with choosing between expensive high quality goods and services and low quality, cheap goods and services. The clothing and food markets in this country provide the best illustration. One is faced with buying clothing and food (of dubious origin and quality) at either open-air markets or significantly more expensive, largely imported goods at shopping malls or the Bosnian equivalent of the High Street. Therefore, the cost advantages of those companies (traders) that avoid taxes and regulations help them keep a large market share in relation to their rule-abiding competitors.

Salvation

McKinsey's report concurs with earlier conclusions as to what needs to be done to rectify this unfortunate state of affairs. Simplification of the tax code and streamlining of the regulatory burden and the registration process certainly bring tangible benefits, as would greater enforcement. Thus, in many cases, increasing enforcement of VAT would often result in revenue sufficiency so that the governments could even contemplate a reduction in the rate of tax without endangering the size of their receipts.

Now that BiH is effecting serious tax reforms and is about to introduce a single VAT rate for the whole country, what lessons can the authorities learn from other countries. The Slovakian example is a good case to point out. From January of this year, Slovakian VAT, income and, corporate tax rates will all be levied at a uniform rate of 19 percent. It is estimated that this will shift some € 484 million from direct to indirect taxes thus encouraging entrepreneurship and investment over consumption. However, as a precaution against overly regressive taxation, the lowest threshold for income tax liability has been increased three-fold. With such a simplified tax code and low corporate taxes, the country is hoping to stimulate foreign investment. In tandem with this tax policy has also been the government's decision to lift the restrictions on the privatisation of 'strategic industries' in sectors such as energy. Furthermore, even the visiting mission of the

¹⁰ Gallagher, Mark & Bosnic, Pero; *Toward an SME-friendly Revenue System*, p. 11

IMF has looked kindly upon Slovakia's tax reform endeavours. In its concluding statement the Fund's mission to Slovakia noted that the 'tax reform appropriately aims to provide better incentives to work and save. The measures sought are likely to improve economic performance.'¹¹ The statement also notes that the uniform VAT rate should lead to better administration and compliance while lower direct taxation is likely to encourage legalisation of the grey economy firms and lead to higher domestic and foreign investment.

Slovakia, however, is partly treading the path that the Republic of Ireland has trodden since the 1950s. Thus, Ireland's long-term productivity and economic boom that has turned an impoverished country on the margins of Europe into a 'green tiger economy' is partly due to carefully laid measures that served as preconditions for higher foreign investment. Ireland has had industrial, tax and, education policies that worked together to create an investor-friendly environment. However, besides these measures the country has also had to learn the virtues of fiscal self-discipline and a determined, consistent and patient policy course that lasts for more than a single term in office. A transparent and rules-based environment, a generally positive attitude to business and policies that supported free international trade and investment also helped attract investors as did the eventual monetary integration into a broader currency area that served as an optimal macroeconomic solution.

Conclusion

Clearly, BiH still carries enormous baggage from the former Yugoslav system that has been complicated by the institutional and economic consequences of the 1992-1995 conflict. Besides the drawbacks that this situation naturally entails, the advantages BiH has are that of any catching-up country, that is, in being able to benefit from the experience of other countries that have had to mend their ways and make themselves more competitive and attractive to investors. Moreover, the EU/ WTO accession processes also serve to provide the impetus for the authorities' reform endeavours. Nevertheless, only a genuine commitment to reform and a cooperative and constructive attitude on behalf of the authorities of this country would enable BiH to reap the eventual fruits of its ongoing labour.

¹¹ Concluding Statement, IMF Staff Visit to the Slovak Republic, October 7-15, 2003

FINANCE and FISCAL SECTOR

Budgets

The June/July period was intensive from the budget calendar perspective. Reports on implementation in 2003 were analyzed in Government and Parliament sessions; execution in the first six months of 2004 was carefully monitored by the Ministry of Finance; and a Memorandum for the 2005 budget is being prepared.

State Budget

Revenues for financing the BiH joint institutions were realized to a level of 96 percent compared to the plan in the period January-May 2004. However, transfer of competencies from the Entities to the State, (e.g. Defense, Intelligence, Indirect Taxation Authority) also required the transfer of funds, which may not be reflected in State budget preliminary execution reports. The importance of the transfer of competencies from the Entity to State level, apart from these being required by EU accession criteria, lies in the prospect that functions now performed at the State level will cost less in the future.

Given the fact that the Council of Ministers adopted the BiH Finance law at its session of 15 July and sent it into Parliamentary procedure, the fiscal prospects for the country seem brighter than before.

Federation of Bosnia and Herzegovina

In the Federation, whose fiscal architecture consists of three levels of government - the Municipalities, the Cantons and the Federation - revenue collection increased compared to last year by an average of 9 percent. This increase, however, was not equally distributed. While Cantons, Municipalities and Funds increased by 16 percent, 12 percent and 10 percent respectively, the Federation actually registered a decrease.

Revenues collected for the first five months of 2004 at the Entity level are at the 93-percent level compared to the same period last year. These opposite trends are the result of revenue sharing legislation in the Federation and the fact that customs revenues, which accrue to the Federation budget, have been lower as a result of the free-trade agreements.

Given the ambitious budget plan for 2004, expenditures could not be financed in the amount budgeted, and the FBiH Government issued a Decision decreasing first-semester entitlements by 20 percent and second-

semester allocations by 10 percent - excluding State financing, and foreign-debt repayment.

Republika Srpska

The draft report on RS budget execution for 2003 has been prepared, and is awaiting RSNA adoption, the budget execution for 2003 is 102 percent, or 1.02 billion KM. For the year 2002 it was 117 percent, or 1.04 billion KM.

The RS budget memorandum for 2005 plans total expenditures in the amount of 1,075.3 million KM, which is 0.1 percent more than the expenditures planned for 2004. For comparison, it is useful to bear in mind that the planned budget for 2003 was 12 percent bigger than the plan for 2002, and the planned budget for 2004 was 7 percent bigger than the plan for 2003. The RS Government is hence downsizing the proportion of its expenditures to GDP, which is in accordance with its long-term goal, though there remains much to be done before this proportion is brought to an internationally acceptable level.

Taxation Reform

Significant progress has been made in the following areas with regard to the indirect tax reform process. The following key laws were adopted on 12 July by the Council of Ministers. These laws are expected to go before the parliament in August or early September:

- Draft Law on Value Added Tax
- Draft Law on Customs Policy
- Draft Law on Allocation and Distribution of Revenues and Payment into the Single Account

One year ago, the actual notion that a BiH-level Law on VAT would be drafted and submitted to the Council of Ministers would have been considered by many to be impossible. While a vast amount of work still needs to be completed with regard to the reorganisation of the Indirect Taxation Authority before VAT can be introduced, these steps all represent progress.

In April, with a view finally to removing the barriers to inter-Entity trade in excisable products, Entity Prime Ministers Hadzipasic and Mikerovic signed what has become known as the "Mrakovica Agreement". Work towards full implementation of this agreement is well underway, which should result in a State-level Sales Tax and State-level Excise Tax Laws. The enactment of these would mean that tax legislation is for the first time placed at the State-level.

In the area of direct tax reform, excellent progress was made at the inter-Entity working group in Neum during the first week of June. The working group produced a harmonised profit law which, when enacted, will mean that the profit tax system across the country will be identical. Furthermore, and of significant importance, companies that operate with business premises in both Entities will no longer be required to file separate Entity profit-tax declarations and will cease to be exposed to double taxation issues, in the event of these laws being passed.

Internal debt

One of the key economic reforms undertaken in 2004 has been the enactment of legislation that contains an implementation plan for dealing with BiH's internal debt. As of 31 December 2002 the total amount of internal debt in the RS was estimated to be 1,761.7 million KM, which is 49 percent of GDP, and in the Federation 3,263.4 KM, or 40 percent of GDP. Debt at the State level is estimated to be 701,000 KM, and can be dealt with in the context of regular budget income.

The structure of the debt is similar in the two Entities; a major portion is related to frozen foreign currency savings and war claims, the remainder is related to general arrears – wages, pensions, liabilities toward suppliers, and invalidity payments. The strategy for dealing with this problem is to set a fixed amount to be paid out in cash and a fixed amount to be settled through the issuance of bonds with a maturity from 20 to 50 years, and to write off the remainder. The Sum of the Net Present Value of the cash payments and issued bonds should not exceed 10 percent of GDP.

The Republika Srpska and the Brcko District had passed their Internal Debt implementation laws by 30 June. The BiH State and the Federation of BiH implementation laws are currently before their respective parliaments and will hopefully be adopted before the end of July. Passage of these laws removes a large source of uncertainty that has hindered efforts to rebuild the economy. Prospective investors no longer have to worry that the governments might be forced to raise taxes to pay off the debt. The settlement will allow governments to plan their spending strategically, knowing exactly how much they must allocate for debt payment. This will clear the way for investment in new jobs and in economic growth.

The passage of the implementation legislation means that actual payment of claims may now commence. The first to be paid will be the pension and invalid arrears and the holders of the smallest frozen foreign currency

accounts. These claims will be paid in cash. All claims must be verified before payment can be made and this means that frozen foreign currency account holders and those with material and non-material war claims must be individually identified and placed in a database that will be used to verify the claims. A public notice will be issued to allow frozen foreign currency account claimants formally to file their claims. These formal requests for payment will then be matched with the claims database to verify the legitimacy of each claim.

Once verified the vast majority of the frozen foreign account claims and war damage claims will be settled through the issue of Government bonds. Prior to this happening an operable bond market and a bond registry must be established to allow the bonds to be issued and traded in dematerialized form or electronically. This will take some time so the bonds portion of the settlement will probably not take place until after the first quarter of 2005. The bonds will be tradable and an active secondary market will be encouraged to allow bond holders to realize maximum value should they decide to sell the bonds before maturity.

The development of a local government bond market will also allow banks to hold and trade the local bond issue, thereby establishing a BiH interest rate for sovereign debt. Sovereign debt is the least risky category of debt issue in a nation, therefore this sovereign debt rate will be a market determined reference that will allow corporate debt carrying higher risk to be priced locally. This in turn will help establish a viable commercial debt market with the potential to stimulate investment and hence jobs and income. Settlement of the country's internal debt will have positive benefits for all BiH citizens.

AGRICULTURE

Veterinary

Following outbreaks of brucellosis and Q fever the BiH authorities have realised that only a systematic and harmonized approach can guarantee efficient protection of animal and human health.

- The Council of Ministers adopted a Decision transferring veterinary border inspectors from the Entity Agriculture Ministries and the Brcko District Agriculture Department to the Ministry of Foreign Trade and Economic Relations – State Veterinary Office (SVO).
- By this Decision the CoM created the preconditions for setting up a single State

veterinary border inspection system under the supervision of the SVO.

- The SVO has been tasked with preparing an action plan and with taking over responsibility for the inspectors by December this year.
- Establishment of the single State veterinary border inspection system means in practical terms that the State-level competent authority, the SVO, will have sole responsibility for managing veterinary border crossings with the aim of implementing and controlling application of BiH foreign trade policy measures and improving the surveillance system in the international trade in animal and animal origin products.

The next crucial step under the umbrella of the SVO is to prepare for the establishment of the State Animal Health Control Programme and the National Epidemiological Unit.

- Establishment of the programme, together with certification of reference laboratories, is of crucial importance for the diagnosis, control, prevention, and eradication of animal diseases.
- The programme will be created to provide implementation in phases and to designate a system for double-source funding, from the private and public sectors.
- Implementation of the programme will depend on the BiH authorities' readiness to provide enough funding in the 2005 budget year.

If the BiH authorities fail to provide sufficient funding there is a real danger that BiH will not be able to meet the EC's stabilisation and association conditions. Also, the epidemiological situation will remain a threat to animal and human health, as well as an impediment to agricultural development.

Phytosanitary

- The BiH Civil Service Agency (CSA) has advertised the post of director, deputy director and director's advisor at the BiH Administration for Plant Health Protection (Phytosanitary Administration).
- The Ministry of Foreign Trade and Economic Relations has submitted to the BiH Ministry of Treasury a draft budget for financing the Administration for Plant Health protection for 2004.
- The BiH HoR Constitutional and Legal Affairs Committee has accepted and forwarded a package of phytosanitary laws (Law on Seed and Seedlings, Law on Mineral Fertilizer, Law on Phyto Pharmaceuticals and Law on Plant

Variety Rights) to the parliament (under urgent adoption procedure).

- When these laws have been adopted and the BiH Administration for Plant Health Protection has been established, BiH will be on the road to fulfilling the requirements for EC stabilisation and association and WTO membership, as well as fulfilling obligations under other international conventions.
- This will be the first time that BiH has enacted State-level agriculture-related legislation that facilitates the consolidation of the Single Economic Space and improves the business environment.

The inter-Entity working group established to prepare the BiH Law on Food Safety has finished the law and delivered it to the CoM. The CoM has adopted and forwarded the law to parliament under semi-urgent procedure. This is also one of the 16 EC requirements.

STATISTICS

- The CoM has been unable to reach agreement on appointing a director and deputy-director of the BiH Statistics Agency.
- As agreement has not been reached, the CoM has launched a new initiative and proposed amendments to the BiH Statistics Law.
- The amendments foresee the introduction of one more deputy director's position.
- It is not known how the BiH parliament will react to the CoM's proposal.
- Meanwhile, the BiH Audit Office has pointed to the lack of financial discipline, and instances of bad financial management in the BiH Statistics Agency.

INFRASTRUCTURE AND UTILITIES SECTOR

Civil Aviation

The life of the Civil Aviation Steering Committee (CASC) was relatively short. However, this did not diminish the scale of its achievement. Following the minutes of the International Steering Committee for BiH (ISCBH), held on November 2002 and led by International Civil Aviation Organisation (ICAO) Europe Head Christian Eigl, the CASC was established, under the responsibility of the OHR. Seven meetings have been held over a 20-month period. Deputy High

Representative and Head of the OHR Economics Department Patrice Dreiski has chaired these meetings, while successive Senior Advisors for Civil Aviation have provided secretariat support.

According to the terms of reference endorsed by the ICAO, the CASC closely monitored and supported substantial and sustained progress made in the implementation of the following issues:

- Reinforcement and improvement of the functioning of BiH civil aviation institutions,
- Assistance and guidance of actions for BiH civil institutions to cope with the ICAO framework,
- Monitoring the safety oversight audit follow-up and the implementation of related action plans, and
- Ensuring the continued appropriate level of conformity of civil aviation activities in BiH to the ICAO, ECAC¹, EUROCONTROL and JAA² requirements.

Six CASC meetings were held and the outcomes of these meetings were very satisfactory, with the result that a full civil aviation structure has been created. This includes: OHR Legal department, the EC/ICAO OPAS project Head, BHDCA representatives, the Law on Civil Aviation (adopted in February 2004), the appointment of the Director General of the BiH Directorate of Civil Aviation (October 2003), the handover of responsibilities for provision of Air Traffic services at Sarajevo International Airport (1 January 2003), after the withdrawal of French DETAIR, the purchase of an approach radar (January 2004), the handover of responsibility for Mostar Airport (1 April 2004), and the adherence of BiH to EUROCONTROL (1 April 2004). The final CASC took place on 21 July 2004.

The full construction of the civil aviation structure has not yet been achieved, but is currently fully under the control of BiH. The completion of this project is still underway, and the following needs to be achieved: Central Europe Air Traffic Services ratification, an Air Traffic Control Management program, including intermediate airspace control from a BiH Air Control Centre (ACC) with its own en-route radar, an Air Information Service, Flight Information Service, Notice to Airmen Office, Metereological Service, competence for Lower Airspace, and the education and training of BiH ACC controllers.

¹ European Civil Aviation Conference

² Joint Aviation Authorities

Corporate Governance

Progress has been made in getting the package of five corporate governance laws adopted. This package, which has the overall goal of improving corporate governance in public companies, evolved as a direct result of the audit reports that were published last year.

The BiH Framework Law on Accounting and Auditing was enacted at the end of June and will become effective in the near future. The Entity laws on Public Enterprises and on Public Procurement have also made significant progress and are already in adoption procedure before the respective Parliaments. The Public Enterprise laws are expected to be adopted before the summer recess. However, the Law on Investment of Public Funds is still only at the initial stages in the Federation, still with the Ministry, while in the RS it has yet to pass its first reading in Parliament.

There is good news with regard to the Law on Obligations. Political consensus has been reached on transferring competence from the Entities to the State and passing this law as a State-level law. This will be an important contribution towards achieving the aim of establishing a Single Economic Space with regard to ownership rights and contractual obligations.

The overall objective of all these efforts remains the same: to close the loopholes of the existing regulations that fail to cover large areas of corporate life. Once the laws are in place they will help to ensure that public companies are able to act as engines of economic growth and attract foreign investment to BiH.

Energy

Energy sector reform is one of the key areas addressed in the European Commission's Feasibility Study.

During the first quarter of 2004, the two critical laws for this sector, the Law on Transmission Company and the Law on Independent System Operator, were adopted by both houses of the BiH Parliament, without damaging amendments that had been proposed. Since the laws have been adopted in somewhat different texts, both laws had to go through harmonization procedure.

On 19 May 2004, the Energy Regulators Regional Association (ERRA) voted to admit the State Electricity Regulatory Commission (SERC) of Bosnia and Herzegovina.

The ERRA is a voluntary organization of independent energy regulatory bodies from the Central/Eastern European and Newly Independent States. The Licensing/Competition and the Tariff/Pricing Committees of the ERRA meet biannually and develop and publish issue papers, discussion papers, and analyses. In addition, an EU Accession Working Group was established to provide a common platform for those ERRA member organizations from countries where EU accession is a high priority for national governments, and EU membership is possible in the near future.

The National Association of Regulatory Utility Commissioners is an associate member of ERRA and has agreed to pair SERC with a U.S. regulator for a mutual exchange of information.

ECONOMIC TRANSITION

Privatization

During the last few months several successful privatization cases have been completed in the FBiH. Also, activities on the joint-venture agreement with a strategic investor and Zenica Steel Company have been ongoing. Agreement with the selected investor was to be concluded in July.

The privatization process in the RS progresses at a very modest pace. The privatization tender of one of the most attractive enterprises, Banjaluka Brewery, failed despite widespread expectations of success. Currently, several tenders have been launched and have attracted investor interest; it remains to be seen whether these tenders will lead to successful privatization.

Business Environment

Framework Law on Accounting and Auditing

On 29 June, the BiH Parliament adopted the Framework Law on Accounting and Auditing. This law mandates the use of international standards in the education, training, professional conduct and lifelong development of accounting and auditing professionals in BiH. A new Commission for Accounting and Auditing Standards will implement uniform testing for accountants and auditors and monitor the implementation of international standards by the profession.

The law provides for a single set of titles to be used by professionals throughout BiH and for mutual recognition of titles between the Entities of BiH.

One of the key goals of this legislation is to foster the development of a competent, credible private-sector accounting and auditing profession, fully empowered to practice countrywide, promoting investment and fostering economic growth.

Credit

The BiH Parliament has enacted the new Framework Pledge Law of BiH, which represents a significant development in the credit market in this country. With the introduction of this legislation and of the new registry (Pledge Registry) established under this law, financial institutions will have a satisfactory legal and institutional environment in which to provide credit secured with movable property.

Credit secured with movable property, such as loans or financial leasing, plays a central role in the development of business, agriculture and consumer sectors in modern economies. This is particularly so in a country such as BiH, where many legal, social and political impediments still render the use of immovable property (real estate) as security for credit not always attractive.

The sustained and productive effort of USAID, working with its local counterparts, in developing the system, along with the support of the OHR and the World Bank, will pave the way for the creation and implementation of the new system. This registry will provide financial institutions with information regarding the existence of claims on movable property before they decide to deal with it, thereby creating a more attractive environment for creditors to advance credit secured with such property.

Bulldozer



Minding our own business

With the start of its Third Phase, the Bulldozer Initiative has seen a further increase in the role of domestic structures. This is the logical continuation of a development that started in the earlier phases. In Phase I, OHR was responsible for the coordination of the entire process, from collecting the initial suggestions from entrepreneurs all the way through to the verification of the implementation of the reforms. In the second phase, six Regional Bulldozer Committees and one national Bulldozer Committee on Agriculture

were established. These committees took on the responsibility of collecting information from entrepreneurs on what it is that makes doing business in BiH difficult. With that information, they formulated the reform proposals that were ultimately presented to the government. Also in Phase II, the prime ministers established the Emergency Reform Units. These units, consisting of young, professional civil servants from some of the most relevant ministries, were tasked with coordinating the adoption and implementation of the reforms. The OHR's role was to help build the capacity of the new structures, and to provide overall coordination of the activities.

The Bulldozer of the Third Phase is a Bosnian Bulldozer, as is indicated by the colours of the new logo. The slogan for Phase III is therefore "minding our own business". That should be taken literally. BiH's entrepreneurs are using the Bulldozer to promote BiH businesses. It is necessary to increase domestic involvement in the Bulldozer, because this – and only this – can make the initiative sustainable. The bottom-up approach is also where Bulldozer has derived much of its power and legitimacy.

The Regional Bulldozer Committees and the Emergency Reform Units will work more closely together throughout Phase III. The Emergency Reform Units will assist the Regional Bulldozer Committees in collecting and reviewing business roadblocks. The Regional Bulldozer Committees will help explain the rationale behind reform proposals during the adoption process and they will collect information to assist in the verification of implementation and assessment of impact. This increased cooperation will enable the Regional Bulldozer Committees to make an earlier evaluation of the feasibility and necessity of suggested reforms. It will also make it easier for the Emergency Reform Units to explain to government officials and parliamentarians why a certain reform is necessary. It should therefore be possible to create reform proposals of even higher quality, and these can be adopted and implemented in a shorter timeframe.

The Regional Bulldozer Committees and the Emergency Reform Units will thus continue to improve their work as representatives of the private and public sector. The overall coordination, which in Phase II was still the responsibility of the OHR Bulldozer Unit, will be gradually transferred to the newly established Employers Organization at the State level.

On 7 July the employers' organizations of FBiH, RS and Brcko held a general assembly in Sarajevo at which they adopted the statutes of the new State-level Employers' Organization. At the end of the general assembly, they formally and publicly handed over the

request for registration of this new organization to Prime Minister Adnan Terzic. This signaled the start of Bulldozer Phase III. The Regional Bulldozer Committees are now collecting new proposals for economic reforms. Several daily newspapers are running advertisements with a form and contact information of the regional bulldozer committees, in order to enable anyone who wants to submit suggestions for economic reforms. On-line forms can also be accessed at <http://www.buldozer.ba> (English version at <http://www.bulldozer.ba>) where people can directly submit reform proposals.

The Bulldozer Committees will work together with the Emergency Reform Units to identify reform proposals that can have the highest potential impact on the business environment in BiH. Once 50 reform proposals have been selected and properly formulated, they will be publicly presented to the governments. The State-level Employers' Organization will then generate publicity for these reforms in order to maximize lobbying effectiveness. The Emergency Reform Units, assisted by the Bulldozer Committees, will explain the reforms to government officials and parliamentarians in order to see speedy adoption. Finally, the implementation of the reform will have to be verified and an assessment of the results will have to be made.

At the end of Phase III, a total of 150 reforms will have been proposed to the government. The large majority of these reforms should have led to significant improvements in the business climate in BiH. That in itself will be a considerable achievement. However, at least as important as the individual reforms will be the establishment of dialogue between the public sector and the private sector. The more conventional forum for such dialogue is the social and economic council. These have been established in many modern economies throughout the world. They currently already exist in the FBiH and in the RS, but not yet at the BiH level. The logical successor of the Bulldozer Initiative, after Phase III, would therefore be a Social and Economic Council at the State level. Discussions with local and international stakeholders to this effect are now underway.

REGIONAL OFFICES

OHR Mostar

Loan guarantee scheme established in the Herzegovina region

The first Loan Guarantee Scheme in the Herzegovina region was signed on 20 April 2004, between

Entrepreneurship and Job Association "LINK" and Universal Bank d.d. Sarajevo, to extend credit to small and medium-sized enterprises. This is a pilot project designed to support the production sector and help SMEs get easier access to credit lines. The project will likewise help establish a formal relationship between the banking community and the SME community, so that together they can work on reducing risk premiums and administrative costs and improve returns on investment.

While the current Loan Fund is 600,000 KM, the value of loans ranges from 5,000 KM to 20,000 KM; the repayment period is five years, the grace period is six months and the interest rate is 6.20 percent. It is expected that successful implementation of the project will encourage other municipalities in the region to adopt this model and put money into the Fund for financing SMEs in their own municipalities.

Social protection laws in canton 7

Although in July 1999 the Federation Government adopted the Law on Social Protection, Protection of Civil Victims of War and Protection of Families with Children, based on which Cantonal Governments were obliged to pass laws on social welfare within the following three months, Herzegovina-Neretva Canton still does not have this regulation in place. As a result of the non-existence of this legislation, and because of a lack of funding in the budget (the main reason the cantonal government has not yet passed the legislation), the overall situation in the field of social protection in HNC is critical.

However, during the last two months or so the situation has slightly improved. At the joint initiative of the non-governmental organization Center for Civil Initiatives and other citizens' organizations in different cities of Herzegovina-Neretva Canton, the signing of a petition for the passage of the abovementioned law was organized. Around 2,900 citizens signed the petition. Furthermore, the Municipal Councils of Jablanica, Ravno and Konjic, as well as Centres for social welfare from Mostar, Ravno, Konjic, Rama, Jablanica and Neum, have expressed their support for this initiative.

Finally, on 21 June 2004, HNC Assembly Councilor Tomislav Pupic started a legal procedure for adoption of this Law by submitting the Draft Law on Social Protection, Protection of Civil Victims of the War and Protection of the Families With Children for parliamentary consideration. The Draft should be discussed soon. Adoption of this legislation would be a first step towards resolving the accumulated problems in this field.

Business service centre in Mostar

Following the successful launch of the Business Service Centre in Zenica-Doboj Canton, Mostar City Administration has decided to launch its own Business Service Centre (BSC), with the support of the German Government and the German Embassy in Bosnia and Herzegovina. To that end, Mostar City Administration, within the Department for Economy and Social Affairs, on 5 May 2004 appointed a working group to set up the BSC.

The main object of the Mostar BSC will be to function as a "one-stop-shop" (providing assistance with administrative procedures to newly established businesses) and an "information and service centre" (creating a database of existing businesses and sharing information within the business community). The BSC will also play an active role in promoting business in the Mostar area, as well as in linking local companies with potential international partners.

The Mostar BSC organized a three-day international economic forum, which took place from 21 to 23 July 2004, coinciding with the re-opening of the Old Bridge, to send the message that Mostar is not just a badly damaged site or, potentially, a nice tourist destination, but that it is a place with lively business activities where citizens are striving to secure a better future through economic regeneration.

Moreover, the Mostar BSC will dedicate its work to the establishment of successful cooperation with the Mostar business community, as well as with governmental institutions and non-governmental organizations working in the economic field, thus promoting the economy and the entrepreneurial spirit of Mostar.

Trade fair and Days of Cherries fair in Mostar

The Seventh International Trade Fair "Mostar 2004" was held at the beginning of April in the Mostar Free-Trade Zone, where a record number of more than 450 exhibitors from around 20 countries presented their products. Bosnia and Herzegovina's partner for this year's fair was Slovenia. Besides businesspeople from these two countries, exhibitors from Croatia, Italy, Macedonia, Serbia and Montenegro, Austria, Germany, Spain, Sweden, the Netherlands, France, Belgium, the Czech Republic, Russia, Japan, Brazil, Pakistan and Korea were present.

During the fair, prizes for the most successful exhibitors were presented to Herzegovina-Neretva Canton Tourist Union, Mostar Guma M, Mostar Euroherc, Mostar Unikomerc, Paoca Andrija Wine-cellar, Ljubuski Roefix,

Sarajevo Gorenje, Zagreb INA, and Slovenian Pionir Korp. Also, for the first time, special prizes were given to 40 producers of the best brands of wine from BiH and abroad. In addition, Slovenian Perutnina Ptuj and Gracanica Koko Dzada signed a contract on business and technical cooperation, under which production in Koko Dzada will be increased.

The second fair for economy, agriculture, food and tourism "Days of Cherries 2004" was held at the beginning of June in Potoci, Mostar. During the fair, 12 "Gold Cherries" and two "Silver Cherries" prizes were given out to the best exhibitors, as well as to the organizers and others contributing to the success of the fair. As well as organic food, fruit, vegetables and spring water, wooden furniture was exhibited. The fair was organized in cooperation with Herzegovina-Neretva Canton Tourist Agency and the Economic Department of the City of Mostar.

Privatization

The privatization process in the region is still moving at an exceptionally slow pace. Although several companies have completed or started the process in the past six months, little progress has been achieved.

In West Herzegovina Canton there are various difficulties, including incorrect opening balance sheets, problems with finding investors, implementation of Article 143 of the Labor Law and other issues related to workers (i.e. fulfilling obligations towards MIO/PIO fund, addressing unpaid obligations, etc.). In general, according to the Privatization Agency Director, the main concern of the Canton's institutions is to take care of employees who remain unprovided-for through the privatization process.

Till now the WH Canton authorities have not launched many activities aimed at attracting investment for privatization. However, the WHC Government has identified Supervisory Boards of non-privatised companies that need to appoint acting directors and work with the Privatization Agency on preparation of the companies' opening balance sheets.

Out of 48 companies that were subject to privatization, only 14 have completed the process, while nine are in the process of privatization and 25 still remain to be privatized. Out of these 25, six are somewhat active while 19 do not have any activities going on. The Canton also has nine public companies for which a privatization model still needs to be determined.

A similar situation can be seen in the Herzegovina-Neretva Canton. Out of 17 companies that were planned to be privatized in 2004 (11 in large-scale and

six in small-scale privatization), only two companies in The large-scale group are currently in the process of concluding privatization contracts (Granit Jablanica and Apro Sunce Neum), while tenders for the sale of state capital in another two companies (MI Soko and Norfish Blagaj) have been announced. In addition, one part of a company from a small-scale group has been partially privatized while the public sale of its remaining parts is currently underway.

The HNC Privatization Agency is in charge of four companies from the List of 56 Strategic Companies. These are Granit Jablanica, Unis Tadviv (it is expected that a part of the company will have to be restructured through a liquidation process), Tobacco Factory Mostar (an international advisor needs to be selected) and Aluminij Mostar (ownership dispute still has to be resolved.)

The Agency still needs to prepare and adopt privatization programmes for 10 companies from the Canton. Currently, an inspection of contractual obligations in 26 companies is being undertaken. Emphasis has been placed on checking whether commitments regarding new investments and employment have been kept.

As for the Eastern Republika Srpska (municipalities of Trebinje, Nevesinje, Gacko, Ljubinje, Bileca and Berkovici), thus far they have privatized only 35 percent of the companies in their region. Currently underway is the reorganization and restructuring of Trebinje Tool Factory, which is on the list of strategic companies, and is the biggest exporter from the RS. This may be a positive step in accelerating the privatization process and economic recovery in the Eastern RS.

OHR Tuzla

Opening of Business Incubator in Tuzla

Tuzla Mayor Jasmin Imamovic initiated the idea of a business incubator project two years ago, and, after extensive preparations, 24 June 2004 saw the business incubator "Lipnica" officially opened. Remarkably, the business incubator project has, as of day one, created 180 new jobs and generated significant interest, leasing premises to seventeen different companies. These businesses are already benefiting from "Lipnica's" inexpensive premises and services offered to its clients.

Conditions for the lease of the business premises primarily focus upon the number of new jobs that will be generated by companies emerging from the incubator. The complete absence of any rental fee has encouraged domestic businesses as well as German,

Italian, Czech, and Slovene companies to apply. A total of 6,000 square metres of business space has already been utilized, with approximately 6,000 vacant square metres left, ready to accommodate new Small and Medium Enterprises and create more jobs.

Of equal significance is the revitalization of this space – once old mining company offices but left unused for a long period – which has been given a much more productive purpose and salvaged from decay.

PDHR visit to Natron, Krivaja Zepce, and Zeljezno Polje

On 28 April 2004 Principal Deputy High Representative Donald Hays visited the Maglaj and Zepce municipalities. Ambassador Hays visited the Natron Paper Factory, where the management that took over in 2001 has reduced the factory's debt and workforce and is now looking for a strategic partner. PDHR Hays visited the company as it was preparing to sign a joint-venture agreement with an Austrian investor. Ambassador Hays also discussed the issue of access to restricted conifer wood reserves, which are in limited supply, as well as pushing the Zenica Doboje Canton Government to establish a forestry agency, so that the cantonal law on forestry may be implemented.

Zenica Doboje Canton, like other communities in BiH, has experienced difficulties in its privatization process. Ambassador Hays visited Krivaja Zepce Furniture Company to discuss ways of speeding up the privatization of wood processing companies in the canton and making the process more efficient.



Raspberry collection point at Zeljezno polje

PDHR also visited a small Bosniak community where the geographical location; shape of terrain; and quality

of soil, have all assisted in the development of a very profitable agricultural project – raspberry growing. Zeljezno Polje farmers – comprising 100 families – have received tremendous encouragement from the dedication and financial support of the Sarajevo Company “Klas” (through whom the raspberries are exported) and the Sarajevo Faculty of Agriculture (which has provided the necessary expertise and has demonstrated a commendable dedication to this project’s success).

The growers also drew attention to the technical assistance they have received from USAID’s sponsorship of agricultural development in BiH. USAID’s project, known as Linking Agriculture to Markets and Producers (LAMP), has been working with these farmers for several months.

BH Steel Privatization

On 3 June 2004, the FBiH Government passed a resolution confirming that 51 percent of BH Steel capital is to be sold to the London-based LNM Company – the second largest steel producer in the world. Negotiations with the new owner regarding the overall contract, which will ultimately clarify the status of BH Steel workers are yet to follow. LNM has made a commitment to initiate vital production within the next two years. Selection of this third strategic partner has brought relief to trade union members, who were anxious to see a strategic buyer who can end their crisis identified.

The Deputy Director of LNM appeared optimistic, with assurances that new electrical furnaces will help production to exceed two million tons per annum.



Workers at BH Steel

BH Railways - PDHR Train Ride

Earlier this year the government of Portugal provided a 32-million Euro loan for the procurement of new freight cars (a donation necessary for FBiH Railways to keep up with growing demand). On 18 June 2004 PDHR Hays met with directors of FBiH and RS Railways, Entity Communication Ministers, and managers of three strategic companies (BH Steel of Zenica, Dobož Limestone Quarry, and Koksara Lukavac). Under discussion was the current and future situation of BiH’s railways, and the important impact that railway transportation will have on the economic development of Bosnia and Herzegovina.

After a brief visit to the BH Steel factory, Ambassador Hays spoke with the Entity ministers and railway directors onboard a train en route from Zenica to Dobož. In Dobož, Ambassador Hays met with the Mayors of the three “Dobož” municipalities to discuss inter-Entity cooperation and municipalization issues. PDHR’s journey continued with a train ride to Tuzla, this time meeting with Tuzla Canton officials on board the train.

Opening of the Cement Factory in Lukavac

Lukavac Cement Factory (Cementara) – privatized in October 2001, and considered one of the most successful privatizations in the Federation – was recently re-opened with 55 million Euros worth of newly built cement production facilities.

Cement production capacity has since tripled, such that, from now on, instead of producing 250,000 tons, Lukavac Cement Factory will be able to produce 700,000 tons of cement per annum.

The Austrian investor “ALAS International” was happy to see building work completed earlier than expected.

Also of interest are the materials used in the Lukavac Cement Factory’s cement production, all of which come from nearby companies: - Tuzla Power Plant provides ashes and slag, “Vijenac” Quarry stone, and Djurdjević and Banovići coal mines produce the necessary coal.

The Cement Factory is therefore a net exporter, importing no production materials.



Detail from the Cement Factory Lukavac opening ceremony

Cement production companies in Lukavac and Kakanj are now capable of satisfying 60 percent of the current BiH demand for cement, and are capable of competing effectively with companies from outside BiH.

OHR Banja Luka

LNM Holding, the second largest steel producer in the world, became the major owner of New Mines Ljubija, acquiring 51 percent of the company.

The agreement on a joint venture between Ore Mines Ljubija and LNM was signed on 30 April 2004. According to this agreement, LNM will invest 51 million KM. Of this sum 25 million KM will be invested in the current business year, and the remaining 26 million KM in the following three years. Between 400 and 450 employees will be engaged in preparing the production process. Once production starts (planned for 2005), 600 employees will produce 1 million tons of ore. For 2006, the plan is to engage 750 employees and reach production of 1.5 million tons of ore. The entire production is scheduled to be processed by LNM owned steel factories in BiH, Serbia, and Romania.

Average net wage in the RS is 418 KM, May 2004

According to Republika Srpska Institute for Statistics data, the average nominal net wage paid in May 2004 was 418 KM, which is two percent higher than the figure for the previous month. The highest increase was in the Fishing Sector (23.3 percent), while the strongest decrease was in the Financial Services Sector, by 5.5 percent.

The average net wage for the first five months of 2004 was 407 KM. During this period, the highest wage was paid in the Financial Intermediation Sector (797 KM),

while the lowest wage was paid in the Hotels and Restaurants Sector (248 KM).

Industrial production in the RS is increasing

In the first five months of 2004, the physical volume of industrial production increased by 10.8 percent, compared to the same period last year. Regarding the physical volume of industrial production, by purpose, for the period January-May 2004, in comparison to the same period last year, production of intermediate goods was higher by 38.1 percent, durable consumer goods by 21 percent, capital goods by 6.8 percent, non-durable consumer goods by 0.1 percent, while production of energy was lower by 1.9 percent.

Index of retail prices increased by 1.7 percent

The index of retail prices for the period January-May 2004 was higher by 1.7 percent, compared to the same period last year. Prices of agricultural products increased by 5.2 percent, industrial food products by 3.5 percent, beverages by 1.9 percent, industrial non-food products by 1.3 percent, and services by 0.8 percent, while prices of tobacco products decreased by 1.4 percent.

BiH Economic Update

BiH Economic Data January – May 2004

Source: FBiH and RS Statistical Offices

Indicator	Federation of BiH	Republika Srpska	BiH (CBBH estimate)
GDP nominal 2000 (Million KM) GDP nominal 2003 (Million KM) Nominal increase 2000-2003	6,698.668 8,223.826 + 18.55%	2,734 2,993 + 9.5%	10,050 12,170 + 21%
Index of Industrial Production 05/04 compared to ∅ 2003 05/04 compared to 05/03	110.8 109.7	99.4 106.6	N/A N/A
Retail Price Index 05/04 compared to ∅ 2003 05/04 compared to 12/03 05/04 compared to 05/03	99.5 99.7	101.7 99.8 102.3	N/A N/A
Average Net Monthly Salary in KM 05/04 Index of Nominal Net Wage 05/04 compared to average for 2003	535.31 2%	418 1.1%	N/A
Number of Employed Number of Registered Unemployed	387.592 (As of 05/04) 309.226 (As of 05/04)	238,190 persons (As of 09/03) 139,106 persons (As of 09/03)	N/A N/A
Number of Pensioners in 05/04 Average Pension in 05/04 in KM	288.986 persons 198,78	185,494 persons 160.69	N/A
Imports 01/04 - 05/04 (Million KM) Exports 01/04 - 05/04 (Million KM) Trade deficit 01/04 05/04 (Million KM) Import/Export	2,841.523 910,963 1,930.830 32%	922.7 269.3 653.4 29.2%	